Approved For Release
2008/03/03 :
CIA-RDP85T00875R00170003

Confidential

[redacted] 25X1

2

DIRECTORATE OF
INTELLIGENCE

Intelligence Memorandum

US-Canadian Balance-of-Payments Outlook

25X1 [redacted]

Confidential

ER IM 72-58
April 1972

Copy No. 99

M-204

WARNING

This document contains information affecting the national defense of the United States, within the meaning of Title 18, sections 793 and 794, of the US Code, as amended. Its transmission or revelation of its contents to or receipt by an unauthorized person is prohibited by law.

GROUP 1
Excluded from automatic downgrading and declassification

25X1

CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
April 1972

INTELLIGENCE MEMORANDUM

US-CANADIAN BALANCE-OF-PAYMENTS OUTLOOK

Summary

1. Although US-Canadian economic relations remain extremely close, their character has changed dramatically. In 1968, for the first time since 1891, the United States had a trade deficit with Canada, and in 1971 the deficit was the largest with any US trading partner, except Japan. Because of a continuing large net inflow of long-term capital, Canada has also run a basic balance surplus with the United States since 1968. The short-term capital outflow has not been large enough to offset this surplus, and Canada's international reserves have increased even after the Canadian dollar was allowed to float in May 1970 – which contradicts Ottawa's claim of a clean float.

2. The 8% Canadian dollar appreciation has had little impact on Canada's trade surplus with the United States. Because many of Canada's exports are sold under long-term contracts or are produced by integrated multinational firms that seek to employ their worldwide capacity in the most efficient manner, the appreciation's impact on exports has been sharply mitigated. Canada has also been unable to significantly reduce its dependence on US long-term capital, largely because the demand for long-term capital in Canada exceeds the domestic supply.

3. By far the most important influence on Canada's balance of payments during the 1972-75 period will be growth rates in Canada and the United States – by comparison the impact of the Canadian dollar's appreciation will be small. In 1972, Canada's trade surplus with the United States will probably fall slightly. Canada's imports from the United States are expected to grow faster than exports to us because the Canadian economy's recovery is out-pacing our own. After 1972, Canada's bilateral trade surplus will probably increase substantially, as economic growth in the United States catches up with the earlier resurgence of economic activity in Canada and new opportunities emerge for exporting natural resources.

Note: This memorandum was prepared by the Office of Economic Research.

25X1

Approved For Release 2008/03/03 : CIA-RDP85T00875R001700030058-3

4. The basic-balance surplus will probably fall somewhat in 1972 and increase during 1973-75. Canada's current account is likely to improve as the deficit on services and transfers grows less rapidly than the trade surplus. Although Ottawa is attempting to reduce foreign borrowing substantially, the large net inflow of long-term capital from the United States is likely to continue, unless the government imposes capital controls or restructures Canada's financial markets.

Discussion

Background

5. US-Canadian economic relations are extremely close and are important for both countries. For Canada they are vital. The United States and Canada are each other's biggest customers; the value of bilateral trade – US $23 billion in 1971 – is greater than that between any other two countries of the world (see Table 1). In 1971 the United States purchased 68% of Canada's exports and provided 70% of its imports. About one-fourth of US trade is with Canada, and the amount is greater than US trade with the European Community (EC) or Japan.

6. The US and Canadian economies are also closely linked by corporate and financial ties. About 30% of US overseas direct investment is in Canada, and US investment in Canada represents about 80% of all foreign investment there. New York is as much the capital market for Canada as the United States. Because of the interdependence of the countries' financial markets, small differences in interest rates can lead to massive flows of funds across the border.

Changing US-Canadian Trade Relations(1)

7. Until recently, Canada had a large trade deficit with the United States. It averaged about $600 million annually in the 1950s and early 1960s. In 1968, however, for the first time since 1891, the United States had a trade deficit with Canada. In 1971, the deficit reached nearly $1.1 billion, and was the largest with any US trading partner, except Japan. Although both US and Canadian trade data show the shift, the two countries' statistics differ considerably. For example, the preliminary US balance-of-payments estimate adjusted for the automotive product valuation

25X6

Table 1

Canada's Balance of Payments: Current Account

Million US $

	1965	1966	1967	1968	1969	1970	1971 a/
Global Balance							
Trade balance	283	427	672	1,414	938	2,986	2,173
Exports	8,253	9,749	10,560	12,576	13,894	16,238	17,569
Imports	7,970	9,322	9,888	11,162	12,956	13,252	15,396
Balance on services and transfers	-1,154	-1,282	-985	-1,371	-1,644	-1,779	-1,947
Of which:							
Interest and dividends	-707	-760	-847	-838	-846	-955	-1,057
Travel	-45	-56	391	-28	-202	-217	-199
Freight and shipping	-86	-60	-29	-27	-56	35	23
Current account balance	-871	-855	-313	43	-706	1,207	266
Balance with the United States							
Trade balance	-762	-676	-424	310	518	1,231	1,089
Exports	4,820	5,965	6,854	8,592	9,992	10,720	11,883
Imports	5,582	6,641	7,278	8,282	9,474	9,489	10,794
Balance on services and transfers	-983	-1,099	-773	-1,020	-1,221	-1,244	-1,453
Current account balance	-1,745	-1,775	-1,197	-710	-703	-13	-364

a. *Preliminary.*

indicates a 1971 trade deficit with Canada of $1.9 billion, while the Canadians report a $1.1 billion surplus with the United States. Offsetting differences appear in other balance-of-payments entries, especially short-term capital and errors and omissions. Because of the large differences between US and Canadian trade statistics, we have developed our own bilateral trade account estimates which we believe are more accurate (see Appendix A).

8. More than half of the nearly $1.9 billion swing in the bilateral trade balance between 1965 and 1971 results from the US-Canadian Automotive Products Agreement. As a consequence of the agreement and continuing Canadian Government pressure on US automotive manufacturers to increase their share of production in Canada, automobile output in Canada increased dramatically and sales to the United States went from $227 million in 1965 to $3,990 million in 1971 (see the chart). Although US sales also increased rapidly, the US-Canadian bilateral account in automotive products shifted from a surplus of $653 million in 1965 to a deficit of $290 million in 1971.

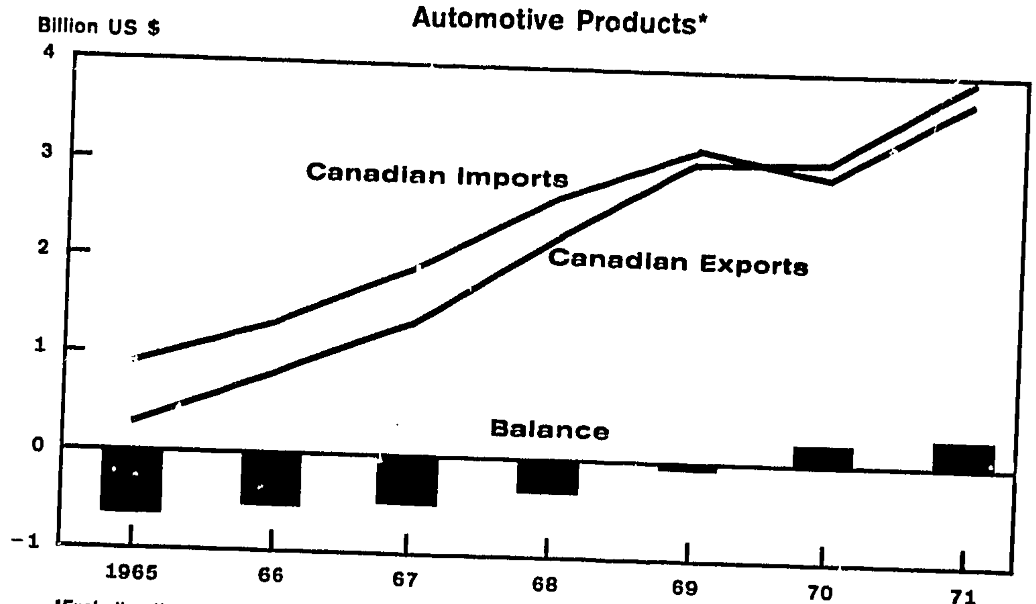
9. Exports of other manufactures[2] to the United States – $2,120 million in 1970 – have also done very well. Sales of these items, which account for one-fifth of total Canadian exports to the United States, have grown 17% annually since 1965. Roughly half of Canada's other manufactured exports are sold by subsidiaries of US companies who produce highly sophisticated and high-growth items, such as computers, telecommunications apparatus, air-conditioning equipment, office machinery, and control devices.

10 Canadian mineral and metal exports to the United States have also increased greatly. Between 1965 and 1970 they grew 11% annually; crude oil and natural gas led the way with an 18% annual expansion. Spurred by an exemption from US oil import quotas until March 1970, Canadian crude oil exports reached 28% of total US imports. In 1971, Canada was the largest single foreign supplier of crude oil and natural gas to the United States, with combined sales totaling about $1 billion.

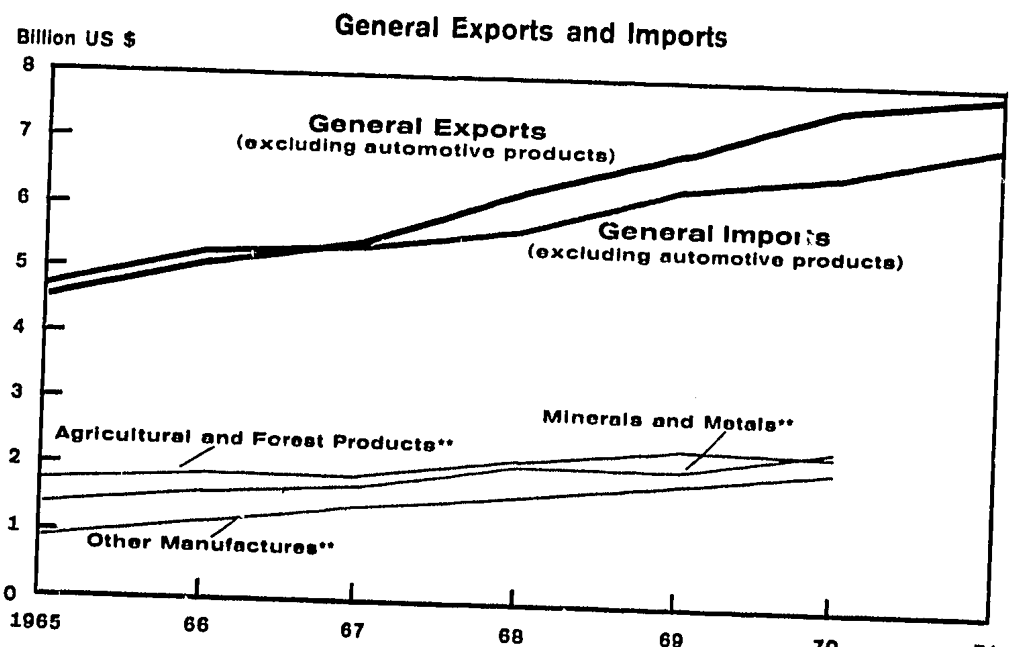
11. Exports of agricultural and forestry products to the United States have grown slowly. Forest product sales increased only 6% annually between 1965 and 1970, reaching $1,930 million. Newsprint exports – which account for almost half of Canada's total forest product exports to the United States – have hardly grown at all as US demand has stagnated. Since

2. Manufactures other than automotive products and processed natural resources such as metals and newsprint.

Trends in US-Canadian Trade



*Excluding tires and tubes



**Based on customs data

513524 4-72

1965, exports of agricultural products to the United States have grown only 5% annually.

12. US exports to Canada (excluding automotive products) – $7.1 billion in 1971 – have increased relatively slowly. Since 1965, they have grown only 7% annually: about 25% less rapidly than Canadian gross national product and 30% slower than Canadian exports to the United States. US export growth has been rapid in consumer durables, aircraft, and specialized production equipment but slow in other manufactures, minerals and metals, and agricultural products.

13. An increased services and transfer deficit with the United States has partly offset Canada's improvement on trade account. Interest and dividend payments on US investments – which account for about 85% of Canada's total interest and dividend payments – increased to $1,350 million in 1971. These payments in 1971 exceeded Canada's bilateral interest and dividend receipts by about $1 billion and the net long-term capital inflow from the United States by almost $650 million. Other service payments – including gross payments for transportation and travel – increased to $2,950 million – $530 million more than other service receipts. Despite the growing services deficit, Canada was able to reduce its current account deficit with the United States from $1.7 billion in 1965 to less than $400 million in 1971.

US-Canadian Financial Relations

14. As a result of the improvement in its bilateral current account and a continuing large net inflow of long-term capital, Canada has run a basic-balance surplus with the United States since 1968 (see Table 2). In part, the long-term capital inflow has persisted because of Canada's partial exemption from the US Interest Equalization Tax, imposed in 1963 to slow down purchases of foreign securities, and its total exemption from the Foreign Direct Investment Regulations, established in 1968 to limit overseas direct investment by US companies.

15. In return for the exemptions from US capital controls, Ottawa initially agreed to impose a $2.55 billion ceiling on its official reserves. The effect of this ceiling was to force Ottawa to adopt monetary policies that would generate a short-term capital outflow sufficient to offset any basic-balance surplus. The ceiling was lifted in late 1968 on the understanding that Ottawa would limit unnecessary borrowing in the United States that would permanently increase reserves, and it would make it more difficult for institutions to evade US regulations by using Canada as a "pass-through" for US capital moving to other countries.

Table 2

Canada's Balance of Payments: Capital Account a/

Million US $

	1965	1966	1967	1968	1969	1970	1971 b/
	Global Balance						
Balance on long-term capital account	799	1,080	1,253	1,528	1,947	707	473
Of which:							
Net direct investment	379	726	524	383	324	469	584
Transactions in Canadian securities	584	672	837	1,415	1,576	527	189
Of which:							
New issues	1,147	1,355	1,209	1,773	1,932	1,168	1,158
Basic balance	-72	225	940	1,571	1,241	1,914	699
Balance on short-term capital account c/	219	-557	-921	-1,248	-1,181	-449	71
	Changes in Reserves						
Changes in reserves arising from balance-of-payments transactions	147	-332	19	323	60	1,466	769
	Balance with the United States						
Balance on long-term capital account	1,079	1,145	1,135	1,049	1,375	859	708
Basic balance	-666	-630	-62	339	672	846	344
Balance on short-term capital account c/	-267	-386	-972	-1,317	-497	-174	824

a. *Because of rounding, components may not add to the totals shown.*
b. *Preliminary.*
c. *Including errors and ommissions.*

16. Continued Canadian long-term borrowing in the United States and elsewhere almost certainly violates the understandings with Ottawa. Although net long-term borrowing in the United States has declined since 1969, it still remains relatively large – $708 million in 1971. The federal government has attempted to reduce the inflow of portfolio capital by encouraging the provincial governments to rely less on the New York capital market, but this attempt has been only moderately successful. The value of new Canadian portfolio issues placed overseas declined to $1,158 million in 1971 from $1,932 million in the peak year of 1969, but this is still a greater portfolio inflow than in any year prior to 1966. The inflow of net direct investment has increased as the economy has grown and additional investment opportunities have become apparent. The direct investment inflow from the United States in 1971 – $590 million – was a record amount.

17. At the same time that Canada was a net importer of long-term capital, it was generally a short-term capital exporter. During the period that the reserve ceiling was in effect -- 1963-68 -- Canadians were encouraged by expansionary monetary policies – low interest rates at home -- to increase their overseas working balances. Although Ottawa has not adhered to a reserve ceiling since 1968, Canadians have continued to increase their overseas balances. But many have opted in recent years to place their short-term funds in Europe rather than in the New York financial market because of higher European interest rates and uncertainties concerning the dollar. This has the unwanted effect of increasing US dollar liabilities in Europe at a time when European central banks are concerned about increases in their dollar holdings. Canada, in effect, is serving as a "pass-through" for US dollars reaching Europe. The "pass-through" totaled about $275 million in 1970 and $755 million in 1971.

18. The short-term capital outflow has not been large enough to offset the basic-balance surplus in recent years, and Canada's international reserves have consequently increased (see Table 3). Because of an unexpectedly large trade surplus, Canada's reserves jumped $1 billion between December 1969 and May 1970. The danger of an unmanageable speculative capital inflow was largely responsible for the government's decision on 31 May 1970 to again float the Canadian dollar.[3]

3. The Canadian dollar floated from 1950 to 1962. During most of this period the dollar's value remained stable at US $1.00-US $1.06. The market over-reacted when Ottawa attempted to "talk the rate down" in 1962, however, and the dollar had to be repegged at US $0.925.

Table 3

Canada's International Reserves a/

Million US $

	Total Reserves	In US Currency
Reserve ceiling	2,550	--
December 1968	3,046	1,965
March 1969	3,011	1,917
June 1969	2,961	1,758
September 1969	2,956	1,668
December 1969	3,106	1,744
March 1970	3,598	2,056
Beginning of float - May 1970	4,084	2,526
June 1970	4,333	2,771
September 1970	4,553	2,905
December 1970	4,679	3,022
March 1971	4,845	3,152
June 1971	4,852	3,186
September 1971	4,992	3,516
December 1971	5,701	4,061
February 1972	5,809	4,049

a. Including allocations of Special Drawing Rights.

19. The Canadian dollar's value has increased from US $0.925 to rough parity with the US dollar, or by about 8% since May 1970. The appreciation has had little impact on Canada's balance of payments, as the trade surplus with the United States is still substantial and reserves climbed $1.7 billion between May 1970 and February 1972, reaching $5.8 billion. This reserve increase contradicts Ottawa's claim of a "clean" float.

Obstacles to More Balanced Flows

20. Canada's continuing highly favorable balance-of-payments performance is attributable both to structural factors that have mitigated and delayed the appreciation's impact on exports and to capital market properties that have led to a continuing long-term capital inflow. The full

impact of Canada's dollar appreciation is unlikely to be felt for around three to five years, as many of Canada's exports are sold under long-term contracts or are produced by integrated multinational firms that seek to employ their worldwide capacity in the most efficient manner. Canada's trade surplus with the United States did decline in 1971, but this was principally due to higher imports resulting from a resurgence of domestic economic activity.

21. Most of Canada's automotive product exports – accounting for about two-thirds of Canada's exports of manufactures to the United States – are produced by subsidiaries of the three major US automotive manufacturers. They continue to operate their newer and more efficient Canadian facilities at virtual capacity despite the currency appreciation. Although the appreciation may affect relative profitability and decisions about future plant location, so far it has had little impact on production or exports.

22. A large share of Canada's raw material exports to the United States are shipped under long-term contracts, and prices have not been adjusted to reflect the currency change. Even where contracts have been renegotiated, problems of over-supply have forced Canadian producers to absorb most of the appreciation. Natural resource exports consequently have not declined as a result of the float, although the profit squeeze may affect future pricing and investment decisions.

23. On capital account, Canada normally borrows long and lends short with the United States. This pattern contributes greatly to the creation of a Canadian basic balance surplus. It results not from any pecularities of Canadian capital markets and savings patterns(4) but rather from a great difference in the relative demand for long-term capital in the two countries. With Canadian financial markets effectively integrated into the US market, the movement of capital resembles that to and from regions of the United States with economic structures similar to those of Canada and the United States. For the foreseeable future, therefore, only US or Canadian restrictions that effectively separate the two markets could halt the net flow of long-term capital from the United States to Canada.

4. Long- and medium-term capital investments account for about the same share of savings in both countries. Although there are numerous problems in raising long-term funds for major projects in Canada because of the market's thinness, the development of financial intermediaries appears to be proceeding at about the same pace in Canada and the United States -- as measured by the ratio of intermediary assets to GNP in both countries and by a comparison of the relative size and types of financial intermediaries.

Balance-of-Payments Prospects, 1972-75

24. The most important influence on Canada's balance of payments with the United States during the 1972-75 period will be the two countries' rates of economic growth. By comparison the impact of the Canadian dollar's appreciation will be small; it is expected to have little effect other than to reduce slightly the incentive to locate new automotive production facilities in Canada and to reduce earnings and investment in the forest products industry. Although exports of other manufactures are relatively price sensitive, half of Canada's other manufactured product exports to the United States are produced by subsidiaries of US companies, many of whom have recently completed new and efficient Canadian facilities, which they are likely to continue to use at virtual capacity despite the currency appreciation.

25. In 1972, Canada's trade surplus with the United States will probably decline somewhat (see Table 4). Canada's economic recovery is likely to out-pace the recovery in the United States and imports are consequently expected to grow slightly more rapidly than exports – about 11% and 9%, respectively, during the year, excluding automotive products (see Table 5 and Appendix B). On the basis of a survey of the three major automotive manufacturers, it appears that Canada's automotive exports and imports will both decline, with the surplus declining slightly. The bilateral trade surplus will probably be in a range from $900 million to $1,100 million. Canada's service deficit with the United States is expected to continue to rise and the long-term capital inflow is expected to increase slightly. In all, Canada's basic-balance surplus with the United States will probably decline slightly to about $200 million.

26. In the 1973-75 period, Canada's bilateral trade surplus will probably double, assuming the Canadian dollar continues to trade near parity with the US dollar. The rate of economic growth in the United States will catch up with the earlier resurgence of economic activity in Canada, and new natural resource exporting opportunities will probably emerge. Canada's exports to the United States (excluding automotive products) will probably increase around 10% to 14% annually; growth will be most rapid for exports of other manufactures and minerals. On the other hand, Canadian imports from the United States (excluding automotive products) are expected to increase only about 8% to 10% annually. The US-Canadian automotive trade balance will probably continue to shift in the United States' favor, although not so strongly that Canada incurs a bilateral automotive trade deficit.

27. These trade forecasts are confirmed both by a disaggregated analysis of the prospects for Canada's exports and imports and by several

Table 4

Canada's Bilateral
Balance-of-Payments Prospects

Million US $

	1971 a/	1972	1973	1974	1975
Trade balance b/	1,089	1,000	1,400	1,800	2,400
Balance on services and transfers	-1,453	-1,600	-1,700	-1,800	-2,000
Of which:					
Interest and dividends	-1,005	-1,100	-1,200	-1,400	-1,500
Current account balance	-364	-600	-300	Negl.	400
Balance on long-term capital account	708	800	800	800	800
Basic balance	344	200	500	800	1,200

a. Preliminary.
b. Based on mid-point of disaggregated product estimates.

large macro-economic trade-flow models Both techniques show that Canada's bilateral trade surplus will decline somewhat in 1972 and will grow substantially thereafter (see Appendix B). 25X6

28. If the Canadian dollar appreciates further, Canada's bilateral trade surplus in the 1973-75 period will, of course, grow less rapidly. Only if Ottawa allows a clean float, or alternatively adjusts its monetary policy to reduce the outflow of short-term capital, will the Canadian dollar appreciate sufficiently to prevent the bilateral trade surplus from rising. This is unlikely to happen, as the Trudeau government feels a favorable exchange rate is required to develop Canadian manufacturing and create jobs for a growing labor force.

29. Canada's current account is likely to improve in the 1972-75 period since the deficit on services and transfers will probably grow less

Table 5

Canada's Bilateral Export and Import Prospects
1972-75

Product	Percentage Distribution 1971	Outlook
Exports		
Automotive	35	Will probably decline by about US $175 million or by about 4% in 1972, and will probably increase about 5% to 7% annually in 1973-75.
Other manufactured	20	Will probably increase about 15% to 19% annually in 1972-75.
Petroleum	10	Will probably increase about 13% to 16% annually in 1972-75.
Other mineral	15	Will probably increase about 5% in 1972, and will probably increase about 10% to 14% annually in 1973-75.
Agricultural and forest	20	Will probably increase about 3% in 1972, and will probably increase about 4% to 8% annually in 1973-75.
Total exports		Will probably increase about 1% to 5% in 1972, and will probably increase about 9% to 12% annually in 1973-75.
Imports		
Automotive	35	Will probably decline by about US $115 million or by about 3% in 1972, and will probably increase about 6% to 8% annually in 1973-75.
General	65	Will probably increase about 10% to 12% in 1972, and will probably increase about 8% to 10% annually in 1973-75.
Total imports		Will probably increase about 5% to 7% in 1972, and will probably increase about 7% to 9% annually in 1973-75.

25X1

rapidly than the trade surplus. Although interest and dividend payments on US investments are expected to increase substantially -- about 11% annually according to US Treasury estimates – the freight and shipping and travel balances will remain essentially in balance.

30. The basic-balance surplus will probably also increase through the period. Ottawa is attempting to reduce foreign borrowing substantially, but it is doubtful that this will be achieved. Sufficient long-term funds will be unavailable domestically to finance the billions of dollars of natural resource projects now under study unless the government imposes new capital controls or restructures Canada's financial markets. Ottawa could try to channel the savings now going abroad in the form of short-term capital or reserve accumulation into long-term Canadian investments, but it is unlikely to pursue such a policy actively, in part, because the provincial governments are opposed, as they would have to pay higher interest rates if they had to borrow more funds domestically. If capital flows are allowed to continue to respond to market forces, there will probably be an annual net inflow of long-term capital from the United States of at least $500 million to $1 billion annually.

APPENDIX A

CIA Estimate of US-Canadian Balance of Payments

The trade and balance-of-payments data employed in this memorandum, although derived essentially from Canadian sources, differ somewhat from both US and Canadian statistics. In particular, the following two adjustments have been made:

1. To estimate the US-Canadian trade balance, import statistics are used almost exclusively.* We use Canadian import statistics as a measure of US exports to Canada while employing US import statistics as a measure of Canadian exports to the United States. Because import surveillance is generally more comprehensive than export surveillance – particularly where the countries are in such close physical proximity – the use of import statistics provides a more accurate estimate of the US-Canadian trade balance than does the use of either of the very different US or Canadian figures for the trade balance.

2. To estimate the real balance-of-payments cost (that is, foreign exchange cost) of US-Canadian trade, an adjustment has been made to reflect the difference between the market value of Canada's reported imports of automotive products (that is, the value used in Canadian import statistics through 1969) and the lower transactions value upon which company payments are actually based. The adjustments made to reduce Canadian imports statistics are:

Year	Million US $
1965	-10
1966	-22
1967	-76
1968	-88
1969	-1

* Preliminary Canadian estimates of exports to the United States in 1971 are higher than preliminary US estimates of imports from Canada. As reported imports should be higher than reported exports, and the available data are preliminary, Canadian export statistics are used. Consequently, in 1971, the US-Canadian trade balance is derived entirely from Canadian sources. For 1970 and 1971, Canadian dollars were converted to US dollars at the rate of 0.958 US dollar per Canadian dollar and 0.990 US dollar per Canadian dollar.

3. The effect of the trade adjustments is to give an estimate very nearly half way between the US figure adjusted for the automotive valuation and the Canadian figure. To offset the trade adjustment, the Canadian short-term capital account has also been altered.

APPENDIX B

Canada's Export and Import Prospects

The trade balance forecasts summarized in the text are confirmed both by a disaggregated analysis of the prospects for Canada's exports and imports and by several large macro-economic trade-flow models. Large models have the advantage that they permit the user to consider the simultaneous interaction of a large number of influences (including the worldwide exchange rate realignment and differences in growth rates among countries). Econometric forecasts, however, particularly those derived from large, essentially untested, trade-flow models, are highly uncertain and are subject to wide margins of error. Disaggregated product analysis facilitates the inclusion of particular structural factors and adjustments that may be omitted in a macro-economic model, but forecasts are still subject to wide margins of error, particularly where there have been substantial structural changes. Fortunately, both techniques yield similar results when projecting Canada's trade account, and it is consequently possible to develop a composite forecast.

Product Forecasts

Individual product forecasts were derived for major categories of US-Canadian trade and are shown in Table 5. The US-Canadian automotive trade balance will probably shift slightly in the United States' favor in 1972, although Canada will continue to benefit from a substantial surplus. On the basis of a survey of the three major US automotive firms, who account for about 80% of US-Canadian automotive trade, it appears that Canada's bilateral automotive trade surplus will decline by about $60 million, to $230 million, in 1972. Canada's automotive exports will decrease about $175 million, and Canada's automotive imports will decline about $115 million.

The Canadian surplus in automotive trade with the United States will probably continue to erode after 1972. Prior to the Canadian dollar's appreciation, production costs were lower in Canada than in the United States; they are now roughly equal in both countries. The incentive to locate new production facilities in Canada has consequently been reduced. Automotive manufactures are therefore unlikely to substantially alter the existing distribution of production. As Canadian demand for North American vehicles increases and absorbs a greater share of Canadian capacity, Canada will export less. In the period to 1975, however, the automotive trade balance will probably not shift so strongly in favor of the United

States that Canada incurs a bilateral automotive trade deficit. A substantial shift of production from Canada to the United States would lead to renewed Canadian government pressure on the companies.

Canada's exports of other manufactures to the United States are likely to continue to grow in the 1972-75 period at about the same rate as they grew in the second half of the 1960s – about 17% annually – despite the Canadian dollar's appreciation. Although exports of other manufactures are relatively price sensitive, half of Canada's other manufactured product exports to the United States are produced by subsidiaries of US companies, many of whom have recently completed new and efficient Canadian facilities, which they are likely to use at virtual capacity despite the currency appreciation. In addition, Canadian unit labor costs will probably rise less rapidly than those in the United States, offsetting somewhat the effect of the currency appreciation. Outside the automotive industry, Canadian labor productivity in manufacturing is generally lower than in the United States. But the gap is expected to close, in part because of extensive federal and provincial government programs designed to increase output and improve efficiency in Canadian manufacturing and to overcome the initial cost disadvantage of locating in Canada. The Canadian government is also continuing to exert pressure on US manufacturers to increase their share of production in Canada. As a result of the incentive programs and government exhortations, National Cash Register has joined many of the other major office machine and computer manufactures – IBM, Control Data, Honeywell, and Sperry Rand -- in announcing plans to establish new Canadian plants. Although existing plants in the United States are under-utilized, the Boeing Company will probably also capitulate to Ottawa's demands, as Douglas Aircraft has done, and increase the relative share of its Canadian production.

Canadian oil and natural gas exports to the United States should increase substantially during the 1970s. US requirements for petroleum products are growing rapidly and Canadian oil is economically attractive to refiners in the oil-deficient areas of the US far west and upper mid-west despite the Canadian dollar's appreciation. Ottawa believes it can increase the volume of its crude oil exports to the United States from developed fields almost 10% annually. With anticipated price increases the value of Canadian petroleum product exports will probably increase about 15% annually in the 1972-75 period, assuming US oil import quotas for Canadian oil continue to increase with Canadian availability.

Canada's other mineral exports to the United States are also likely to grow substantially in the 1970s, although the outlook for 1972 is not bright. Slack world demand for nickel, copper, iron, and aluminum and growing world capacity have forced down mineral prices worldwide. However, accelerating economic growth in the United States and Japan –

which together take about 60% of Canada's mineral exports – should stimulate demand and push prices up after 1972. Canada is in an excellent position to satisfy this growing demand. For most important minerals, Canada is likely to maintain or increase its share of US consumption. Canadian mineral exports to the United States will therefore probably grow about 12% annually in the 1973-75 period.

Canada's exports of agricultural and forestry products to the United States will probably grow relatively slowly in the 1972-75 period. US demand for newsprint – which accounts for about 35% of Canada's total agricultural and forestry products exports to the United States -- is increasing only 3% to 4% annually (in quantity). Although increasing labor costs and declining profits will force up prices, the industry is plagued by excess capacity. The value of Canadian newsprint exports to the United States will probably increase only 5% annually over the period. The outlook for exports of pulp and lumber also is relatively poor. Overcapacity, declining profits, and growing competition are likely to preclude any significant export growth in 1972. After 1972, the value of these exports should increase about 6% annually. Agricultural exports – which account for only 20% of total agricultural and forest products exports to the United States – are likely to continue to grow in the 1972-75 period at about the same rate as they grew in the second half of the 1960s – about 5% to 6% annually.

Canada's merchandise imports from the United States – excluding automotive products -- will probably grow slightly less rapidly than Canadian GNP through most of the 1972-75 period. Most estimates of Canada's income elasticity of demand for imports from the United States fall in a range from 0.6 to 1.1, holding relative prices and differences in demand pressure in the two countries constant. In 1972, however, prices will rise somewhat faster in Canada. Canada's economic recovery is also more advanced than the US recovery, and demand pressure will consequently be greater. Canadian demand for US exports (excluding automotive products) should increase about 10% to 12% in 1972, or about two percentage points faster than GNP. In the 1973-75 period, relative prices and differences in demand pressure in the United States and Canada should be small, and the rate of growth in Canadian demand for US products will decline to around 8% to 10%, somewhat less than the rate of growth in GNP. The same factors that reduce the appreciation's impact on Canadian exports also mitigate the impact on imports.

25X1

Page Denied